

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF CANEY CREEK                    )  
WATER AND SEWER DISTRICT FOR A RATE            )  
ADJUSTMENT PURSUANT TO THE                    )     CASE NO. 9611  
ALTERNATIVE RATE FILING PROCEDURE            )  
FOR SMALL UTILITIES                            )

O R D E R

IT IS ORDERED that:

1. The Staff Audit Report for Caney Creek Water and Sewer District ("Caney Creek") attached hereto as Appendix A shall be included as a part of the record in this proceeding.

2. Caney Creek shall have until the close of business on September 8, 1986, or within 1 week from the date of this Order, whichever is later, to file written comments concerning the contents of Appendix A.

Done at Frankfort, Kentucky, this 2nd day of September, 1986.

PUBLIC SERVICE COMMISSION

  
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For the Commission

ATTEST:

\_\_\_\_\_  
Executive Director

**APPENDIX A**

**APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION  
IN CASE NO. 9611 DATED SEPTEMBER 2, 1986.**

**COMMONWEALTH OF KENTUCKY  
PUBLIC SERVICE COMMISSION**

**REPORT ON  
THE LIMITED SCOPE AUDIT  
OF  
CANEY CREEK WATER AND SEWER DISTRICT**

**Prepared By:  
Aaron Greenwell  
Public Utilities Financial  
Analyst Chief  
Gas and Electric Revenue  
Requirements Branch  
Rates and Tariffs Division**

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REPORT ON LIMITED AUDIT  
OF  
CANEY CREEK WATER AND SEWER DISTRICT  
CASE NO. 9611

PREFACE

On June 19, 1986, pursuant to the Alternative Rate Adjustment Rate Procedure for Small Utilities, 807 KAR 5:076, Caney Creek Water and Sewer District ("Caney Creek") filed an application with the Commission for rate adjustment.

The Commission staff performed an audit, limited in scope, on the operations of Caney Creek. The audit was conducted by Aaron Greenwell of the Division of Rates and Tariffs on July 14, 1986, at the offices of Caney Creek's CPA, Darrell Madden. Further examination of information requested during the audit was completed at the Commission's offices.

SCOPE

The scope of this audit was limited to determining whether the operating expenses reported in the 1985 Water and Sewer Annual Reports were accounted for in accordance with the Uniform System of Accounts ("USoA") and were representative of normal annual operations. During the audit, records relating to water sales were reviewed, monthly summaries of operating revenue were examined, an analysis of test year disbursements was compiled, invoices and other documents relating to test year expenditures were examined, Caney Creek's depreciation schedule was analyzed, and the minutes of Caney Creek's commissioners' meetings were

reviewed. In addition, Mr. Madden was questioned regarding Caney Creek's financial policies and procedures and the accounting treatment accorded specific expenditures.

#### FINDINGS

A review of Caney Creek's accounting system revealed that the financial records were not maintained in accordance with the USOA as required by the Commission. It was discovered that, for accounting purposes, Caney Creek was treated as a single operating unit. Operating revenues for each division were recorded separately based on actual figures. However, depreciation expense was allocated based on an asset breakdown and all other expenses were allocated on a ratio of 62 percent to the water division and 38 percent to the sewer division.

When this accounting treatment was discussed with Mr. Madden, he decided to meet with Caney Creek's operator, Delmar Slone, to determine a more proper separation and allocation of expenses. As a result, amended 1985 Annual Reports have been filed for both the water and sewer divisions. Mr. Madden's workpapers supporting the amended reports were also provided.

Caney Creek was granted a certificate of public convenience and necessity for a proposed construction project, by the Commission in its Order dated August 7, 1984.<sup>1</sup> A certificate was granted for supplemental construction and the Commission's

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<sup>1</sup> Final Order dated August 7, 1984, Case No. 9087, The Petition and Application of Caney Creek Water District for Certificate of Public Convenience and Necessity.

original Order was affirmed by Order dated May 1, 1985.<sup>2</sup> During the audit, it was discovered that Caney Creek's CPA had no accounting information with regard to the construction project and that Caney Creek's financial records reflect no aspects of this construction. Subsequent review of the minutes of Caney Creek's commissioner's meetings revealed that at the April 1986 meeting, the board determined to obtain financial statements pertaining to the construction project.

The following discussion of the findings of the audit and recommended adjustments to the test-period operating revenues and expenses are based upon the amended reports and workpapers.

#### WATER DIVISION

##### Pumping Expenses - Operation Labor

Caney Creek reported test year charges to this account of \$2,478. During the test year, Caney Creek issued checks totaling \$500 for analysis and testing which should have been charged to this account, but were erroneously charged to other accounts. Eighty-three dollars (\$83) represented by check nos. 2968, 3001 and 3002, improperly charged to Transmission and Distribution Expenses - Maintenance of Other Plant, has been reclassified to this account. The remaining \$417 originally charged to Outside Services Employed has also been reclassified to this account. Included in that amount is \$56 paid by check no. 2925 but incurred

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<sup>2</sup> Final Order dated May 1, 1985, Case No. 9087, The Petition and Application of Caney Creek Water District for Certificate of Public Convenience and Necessity.

in 1984, outside the test year. Therefore, Pumping Expenses - Operation Labor has been increased by \$500 to \$2,978.

Transmission and Distribution Expenses - Maintenance of Other Plant

As discussed above, \$83 of the total charges of \$2,711 has been reclassified. This reclassification reduces this account to \$2,628.

Administrative and General Expenses - Office Supplies and Other Expenses

The reported expense of \$359 has been increased by \$63 representing travel expenses of the district's chairman. This amount has been properly reclassified from transportation expenses, the account originally charged with this expense.

Administrative and General Expenses - Outside Services Employed

Caney Creek reported a test year expense of \$3,149. As previously noted in this report, this account has been decreased by \$417 improperly charged. This account has been further decreased by an additional \$330 paid by check no. 3066 to Howard Consultants. Howard Consultants was engaged by Caney Creek to investigate complaints that the drilling of a new well, as part of the construction project, had caused surrounding wells to go dry. This fee should more properly be capitalized as part of the costs of the construction project, therefore, Outside Services Employed has been decreased by \$747 to \$2,402.

### Administrative and General Expenses - Property Insurance

Caney Creek charged \$631 during the test year to property insurance. Caney Creek actually incurred property insurance expenses of \$751 during the test year and according to the quarterly allocation of sewer and water expenses filed subsequent to the audit allocates 20 percent of this expense to the water utility operations and 80 percent to sewer utility operations. Applying this ratio to the test year expense results in an allocation of \$150 to water and \$601 to sewer. Therefore, property insurance has been reduced by \$481 to \$150.

The effect of these adjustments on the water division's 1985 operating statement is as follows:

#### Audit Report Adjustments

##### Water Division

Acct. No.	Account Name	Test Year Per Annual Report	Staff Audit Adjustments	Staff Adjusted
<u>Operating Revenues:</u>				
460	Unmetered Sales	\$ 1,620	\$ -0-	\$ 1,620
461	Metered Sales:			
	Residential	10,846	-0-	10,846
	Commercial	4,975	-0-	4,975
	Industrial	11,101	-0-	11,101
	Total	<u>\$ 26,922</u>	<u>\$ -0-</u>	<u>\$ 26,922</u>
470	Penalties	\$ 488	\$ -0-	\$ 488
474	Other Water Revenues	<u>40</u>	<u>-0-</u>	<u>\$ 40</u>
	Total Operating Revenues	\$ 29,070	\$ -0-	\$ 29,070
<u>Operating Expenses:</u>				
600	Operating Labor	\$ 826	\$ -0-	\$ 826
605	Maintenance of Water			
	Source Plant	413	-0-	413
620	Operation Labor	2,478	500	2,978



Acct. No.	Account Name	Test Year Per Annual Report	Staff Audit Adjustments	Staff Adjusted
622	Fuel or Power Purchased for Pumping	10,424	-0-	10,424
625	Maintenance of Pumping Plant	413	-0-	413
630	Operation Labor	2,478	-0-	2,478
635	Maintenance of Water Treatment Plant	275	-0-	275
651	Maintenance of Mains	275	-0-	275
652	Maintenance of Services	275	-0-	275
654	Maintenance of Other Plant	2,711	<83>	2,628
901	Meter Reading Labor	826	-0-	826
903	Supplies and Expenses	1,675	-0-	1,675
921	Office Supplies and Other Expenses	359	63	422
923	Outside Services Employed	3,149	<747>	2,402
924	Property Insurance	631	<481>	150
926	Employee Pension & Benefits	270	-0-	270
933	Transportation Expenses	410	<63>	347
403	Depreciation Expense	11,272	-0-	11,272
408	Taxes Other Than Income Taxes	728	-0-	728
	Total Operating Expenses	\$ 39,888	\$<811>	\$ 39,077
	Operating Income <LOSS>	\$<10,818>	\$ 811	\$<10,007>
	<u>Other Income/&lt;Deductions&gt;:</u>			
419	Interest and Dividend Income	232	-0-	232
427	Interest on Long-Term Debt	<3,633>	-0-	<3,633>
431	Other Interest Expense	<2>	-0-	<2>
	Total Other Income/<Deductions>	\$ <3,403>	\$ -0-	\$ <3,403>
	NET INCOME <LOSS>	<u>\$&lt;14,221&gt;</u>	<u>\$ 811</u>	<u>\$&lt;13,410&gt;</u>

#### SEWER DIVISION

##### Labor and Expenses - Treatment System

During the test year, Caney Creek charged \$195 for analysis and testing to other accounts. According to the USoA, \$65 has been reclassified to this expense from Maintenance of Treatment

and Disposal Plant, the account originally charged. Additionally, \$130 erroneously charged to Miscellaneous General Expenses has also been reclassified. As a result of the reclassification, treatment system expenses have been increased by \$195.

Maintenance of Treatment and Disposal Plant

The reported expense of \$524 has been decreased by \$65 to \$459 as a result of the reclassification of the analysis and testing fees discussed above.

Insurance Expenses

Caney Creek reported test-year insurance expense of \$120. However, as discussed in the Water Division section of this report, \$601 should have been allocated to the sewer division. Therefore, insurance expense has been increased by \$481 to the \$601 level.

Miscellaneous General Expenses

Caney Creek reported test-year Miscellaneous and General Expenses of \$344. As previously noted, \$130 for analysis and testing has been reclassified. This account has been further decreased by an additional \$41 with which this account was erroneously charged. The total decrease of \$171 lowers this expense to \$173 as determined herein.

Taxes Other Than Income Taxes

The reported expense of \$493 has been increased by \$4 to \$497 as determined herein.

The effect of these adjustments on the Sewer Division's 1985 operating statement is as follows:

# Audit Report Adjustments

## Sewer Division

Acct. No.	Account Name	Test Year Per Annual Report	Staff Audit Adjustments	Staff Adjusted
<u>Operating Revenues:</u>				
521.1	Flat Rate Revenues	\$ 960	\$ -0-	\$ 960
<u>Measured Revenues:</u>				
522.1	Residential	9,519	-0-	9,519
522.3	Industrial	8,269	-0-	8,269
	Total	<u>\$ 17,788</u>	<u>\$ -0-</u>	<u>\$ 17,788</u>
532	Penalties	269	-0-	269
536	Miscellaneous Operating Revenues	<u>16</u>	<u>-0-</u>	<u>16</u>
Total Operating Revenues		\$ 19,033	\$ -0-	\$ 19,033
<u>Operating Expenses:</u>				
701-A	Labor & Expenses - Collection System	\$ 5,506	\$ -0-	\$ 5,506
701-C	Labor & Expenses - Treatment System	-0-	195	195
703	Fuel & Power Purchased for Pumping & Treatment	493	-0-	493
714	Maintenance of Treatment & Disposal Plant	524	<65>	459
921	Office Supplies & Other Expenses	305	-0-	305
923	Outside Services Employed	2,078	-0-	2,078
924	Insurance Expense	120	481	601
926	Employee Pensions & Benefits	180	-0-	180
929	Transportation Expenses	230	-0-	230
930	Miscellaneous General Expenses	344	<171>	173
403	Depreciation Expense	8,503	-0-	8,503
408.1	Taxes Other Than Income Taxes	<u>493</u>	<u>4</u>	<u>497</u>
Total Operating Expenses		<u>\$ 18,776</u>	<u>\$ 444</u>	<u>\$ 19,220</u>

Acct. No.	Account Name	Test Year Per Annual Report	Staff Audit Adjustments	Staff Adjusted
	<u>Operating Income</u>	\$ 257	\$ <444>	\$ <187>
	<u>Other Income/&lt;Deductions&gt;:</u>			
419	Interest and Dividend Income	\$ 154	\$ -0-	\$ 154
427	Interest on Long-Term Debt	<3,784>	-0-	<3,784>
	NET INCOME <LOSS>	<u>\$ &lt;3,373&gt;</u>	<u>\$ &lt;444&gt;</u>	<u>\$ &lt;3,817&gt;</u>

#### CONCLUSIONS AND RECOMMENDATIONS

It was noted in the Findings section of this report that Caney Creek's financial records were not maintained in accordance with the USOA as required by the Commission, and that for accounting purposes Caney Creek was treated as a single operating unit. When this situation was discussed with Darrell Madden, Caney Creek's CPA, he agreed to convert and maintain the financial records in accordance with the USOA. Subsequent to the on-site audit, the CPA met with Caney Creek's manager in an effort to separate the expenses attributable to each division and allocate common expenses on the basis of time. While the amended annual reports distribute expenses on a more equitable basis than the reports originally filed, and do appear to fairly present the operations of each division, the allocation of common expenses is still an estimate rather than an allocation supported by detailed records.

Caney Creek should maintain separate financial records for the sewer and water divisions, and should keep records adequately

detailed to allocate or specifically identify the expense common to each division. This should include work orders, time cards or any additional information supporting an allocation of common expenses on a time basis, and separation of the gross plant and accumulated depreciation.

Additionally, Caney Creek should obtain and review all financial information regarding the construction project. Immediately after this review, Caney Creek's financial records should be updated to reflect this project.

With the exception of the items noted in the report, Caney Creek's financial transactions were generally properly accounted for and do appear to fairly present the operations of each division.

Respectfully Submitted,

Aaron Greenwell  
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Public Utilities Financial  
Analyst Chief  
Gas and Electric Revenue  
Requirements Branch  
Rates and Tariffs Division